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UNCLAS SECTION 01 OF 03 ANKARA 003677

SIPDIS

SENSITIVE

STATE FOR E, EUR/SE, AND EB/IFD
TREASURY FOR OASIA - RADKINS AND MMILLS
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TAGS: EFIN ECON EIND PGOV TU
SUBJECT: "THE LAST COMMUNIST TOWN IN TURKEY"

REF: A. ANKARA 3257
¶B. ANKARA 3585

¶1. (Sbu) Summary: A trip to two Black Sea towns dominated by steel and coal parastatals, provided a glimpse of two very different state-owned companies. The coal company is a perennial money-loser with backward technology, a politically powerful, highly-paid, unionized labor force, with nary a hint of privatization. The steel company, on the other hand, appears reasonably well-run, currently profitable and partially- owned by investors on the stock exchange. However, since the steel company could actually be privatized, the GOT,s slowness to do so is revealing of Turkish recalcitrance about meaningful privatization. End Summary.

¶2. (U) Econoff and econ specialist traveled in early June to the towns of Eregli and Zonguldak on the Black Sea coast. Eregli,s economic activity is dominated Erdemir the state-controlled and 50-percent state-owned steel company which has its headquarters there. Zonguldak,s business life is dominated by the 100-percent state-owned coal mining company, TTK.

Zonguldak, "The Last Communist Town in Turkey":
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¶3. (Sbu) In Zonguldak, where coal has been mined since late Ottoman times, the town,s economic life is dominated by the 100-percent owned coal company, TTK. Emboffs met first with the President, Secretary-General and Press Officer of the local chamber of commerce: Mr. Salih Demir, Ms. Renda Okay, and Mr. Kemal Mert, respectively. These private business people were scathing about TTK in many respects. They pointed out that it was difficult for local businesses to compete with TTK,s highly-unionized and highly-paid (by Turkish standards, anyway) labor force. Mert said that TTK employees are paid TL 1.3 billion (about $900) a month whereas the going wage for an unskilled laborer is about TL 400 million ($ 260). Note: At this salary, TTK employees earn about $12,000 per annum, more than three times Turkey,s per capita GDP. End Note. The Chamber of Commerce officials said the coal miners, labor union is very powerful politically, and that no Turkish official dares talk about privatizing TTK. Emboffs couldn,t help noticing that the coal miners, union building in central Zonguldak was noticeably nicer than the Chamber of Commerce building.

¶3. (Sbu) Though Zonguldak had the feel of a run-down coal-mining town, the Chamber of Commerce officials said there is nevertheless some local business other than TTK. Renda said the Chamber had helped get a ferry company to begin service from the Ukraine to Zonguldak, which has brought in some suitcase trade (i.e. Ukrainian traders and individuals who come to Turkey on short consumer-goods buying trips). Salih himself runs a private coal mining company, leasing mines that TTK is no longer using and using lower-wage workers to turn a profit. Renda said there were some small textile firms that do subcontracting for bigger textile exporters, but the number of workers employed in this line of work shrank by more than 50 percent with the 2001 financial crisis, and has not come back.

¶4. (Sbu) Citing the role of the labor union, and the heavy presence of the TTK parastatal, Mert said Zonguldak is "the last communist town in Turkey." The Director General of TTK, Rifat Dagdelen is a career government employee in the mining sector, whom the Chamber of Commerce people characterized as a communist type. When emboffs went to meet with the TTK manager, a floor-to-ceiling photo of the face of a coal miner--much larger than the requisite picture of Ataturk--provided symbolic reinforcement to the Chamber of Commerce official,s point. The DG seemed reticent to provide much information, saying it was inappropriate, for example, to provide us a financial statement. He did reveal, however, that TTK turned in a TL 493 trillion ($326 million) loss in 2003. When asked whether there was any consideration to privatizing TTK, he said there was none. Note: TTK, like a number of other state-owned companies in Turkey, are owned not by the Privatization Authority, but by the Turkish Treasury. These companies, such as TTK and the railroad, are considered either too unprofitable to privatize or too politically sensitive, but they remain a long-term drain on the state. End Note.

¶5. (Sbu) The DG emphasized TTK,s profound need for investment, repeating this point several times, and implying that the state had underinvested in TTK for decades. According to both the DG and the Chamber of Commerce officials, the new mining law, which was passed by the Turkish parliament in recent weeks, may open the way for some private sector investment. First, TTK will conduct tenders for Build-Operate (but not repeat not Build-Operate-Transfer) coal-washing contracts. Bidders would be required to bid to wash each ton of coal at a given price. Under the new law, TTK would also have expanded scope to lease out mines to private companies.

Erdemir: a (missed) opportunity for a privatization:
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¶6. (Sbu) Erdemir, the 50-percent state-owned steel company, seemed quite the opposite of TTK. Erdemir gave every impression of being a reasonably well-managed, currently profitable, stock exchange-quoted company. Emboffs met with Erdemir Director-General Kerim Dervisoglu, who said he had come out of retirement to manage the company after some less-successful managers had run into problems a few years ago. Dervisoglu, who had spent his career with the company and said he had been trained by Americans from U.S. Steel, came across as a business-oriented steel expert, as did his board member colleague, Ali Sedat Kara, and SVP for operations, Fadil Demirel. Note: Erdemir has an significant American connection. A USAID loan in the 1960,s played a key role in the financing, and U.S. Steel helped set up the company and train the staff. End Note. In a quick plant tour of Erdemir,s large flagship complex at Eregli, the production lines were of varying vintage but included one mid-nineties coil rolling facility that seemed very modern. Erdemir officials said they are working towards complying with ISO 14000 environmental and safety standards.

¶7. (Sbu) Erdemir is the largest steel company in Turkey. It produced 3.5 million tons of steel in 2003, with sales of $1.3 billion in 2003, up from five straight years of less than $1 billion in sales. Whereas Erdemir ran small losses for four of the previous five years, in 2003 it turned a healthy $360 million net profit. By all accounts, Erdemir is on track to do well in 2004 as well. Osman Ilter, the Privatization Authority Vice President responsible for the Erdemir privatization process, recently told econoffs that Erdemir could not keep up with surging local demand for steel from the booming Turkish auto and white goods sector, which Dervisoglu confirmed. Ilter said that, for this reason, Erdemir, even though it is theoretically on the verge of being privatized, is going ahead with a self-financed expansion to 7 million tons capacity. Dervisoglu explained that the expansion will take place in stages, expanding to 4.5 million tons by the end of 2005 and to 7 million tons of capacity by 2007. Dervisoglu pointed out that the Erdemir Group also owns 90

percent of Isdemir, the steel company in Iskenderun, in Southeast Turkey, and that the group is making a significant investment to convert Isdemir's production entirely to flat products by 2007. Note: These capacity-expansion investments are among a relatively small number of such investments in Turkey that post is aware of. End Note.

¶8. (Sbu) A combination of strong local demand, decent management and, more recently, favorable global steel prices, have sharply improved Erdemir's performance and near-term prospects. Econoff had asked Ilter why the GOT did not take advantage of favorable conditions and performance to move quickly to privatize Erdemir, particularly since Ilter said two big steel groups (Arcelor and LNM of India) were interested. Ilter said two potential bidders were not enough, and that they needed to await the privatization of the oil refinery, TUPRAS, to demonstrate credibility. He also complained that the recent reduction of Chinese steel prices had unfairly reduced Erdemir,s stock market value. Unlike most Turkish state companies, nearly half (46.27 percent) of Erdemir's shares are quoted on the Istanbul Stock Exchange, a fact that could, in theory help the Privatization Authority's problem with evaluating whether bids on block sales reflect a "fair" valuation.

¶9. (Sbu) Dervisoglu said nothing about privatization, and gave every indication that he and his team would be running the company for the foreseeable future. Though Dervisoglu talked like a company man, rather than a bureaucrat, he and his fellow board members are appointed by the state. Even if, as Finance Minister Unakitan recently suggested on a U.S. trip, Erdemir is able to float some additional shares in the U.S., giving private shareholders majority ownership, the state would most likely retain effective control through its power to appoint board members.

Comment and Conclusion:

¶10. (Sbu) Erdemir and TTK are in some ways symbolic of the two categories of state-owned companies in Turkey. Erdemir, like many of the companies in the Privatization Authority,s portfolio, has real value, and could be privatized with the consequent benefits of efficiency gains and sales proceeds which would help the state reduce its debt burden. Instead, of moving quickly to privatize, however, the state gives every appearance of moving at a snail,s pace, meanwhile happily retaining control, with the political power that implies.

¶11. (Sbu) TTK, at the other end of the spectrum, is a politically-untouchable, loss-making, throwback to an earlier age, and will probably stay that way for some time. Each company, in its own way, exemplifies how deeply-rooted is Turkish state ownership of at least a portion of the corporate sector.
EDELMAN